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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

JOHNSON FARE BOX COMPANY,
Petitioner,

against

LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor,

SURFACE TRANSPORTATION CORPORATION OF NEW YORK, Debtor,

WESTCHESTER STREET TRANSPORTATION COMPANY, INC., Debtor,

THE WESTCHESTER ELECTRIC RAILROAD COMPANY, Debtor,

THE YONKERS RAILROAD COMPANY, Debtor, and

WARONTAS PRESS, INC., Debtor,
Respondents.

PETITION FOR CERTIORARI

No. 1045

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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JOHNSON FARE BOX COMPANY, Petitioner, *against* LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor, SURFACE TRANSPORTATION CORPORATION OF NEW YORK, Debtor, WESTCHESTER STREET TRANSPORTATION COMPANY, INC., Debtor, THE WESTCHESTER ELECTRIC RAILROAD COMPANY, Debtor, THE YONKERS RAILROAD COMPANY, Debtor, and WARONTAS PRESS, INC., Debtor, Respondents.	PETITION FOR CERTIORARI No.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE HONORABLE: THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above-entitled case on January 6, 1958.

Citations to Opinions Below

The opinion of the District Court (46a-48a)* is not reported. The opinion of the United States Court of Appeals, printed in Appendix A, *infra*, page 24, is reported at 250 Fed. (2d) 656.

Jurisdiction

The judgment of the United States Court of Appeals was dated and entered on January 6, 1958 (54a) and is printed in Appendix B, page 28, *infra*. On April 2, 1958, Mr. Justice Harlan entered his order extending to June 5, 1958 the time of the petitioner to petition for a Writ of Certiorari (Appendix C, p. 29, *infra*).

The jurisdiction of this Court is invoked under 28 U.S.C. §1254 (1).

Questions Presented

1. Whether in a reorganization proceeding a claim for the price of fare boxes delivered to a railroad or transportation corporation within six months of the appointment of Trustees is entitled to priority where *admittedly*

(a) the claim was a current liability contracted with the expectation of the supplier that it was to be paid out of current earnings;

(b) the boxes were intended for and were used in the ordinary operations of the company, were used in old buses to replace boxes which had become obsolete with an increase in the fare, and did not involve an extension of the transportation system;

* Figures in parentheses refer to pages of the printed Appendix to Appellant's Brief in the United States Court of Appeals.

(c) the new boxes became subject to the existing mortgage and enured to the benefit of the mortgage holders;

(d) the substitution of new boxes for the old ones was found by the District Court to be "*imperative*"; and

(e) Shortly after the appointment of the Trustees, they ordered a large number of additional identical fare boxes of the character here involved, setting forth the urgent need therefor.

2. Whether a claim for the price of fare boxes (which would otherwise be entitled to priority under the six months' rule) should be denied priority on the sole alleged ground that the fare boxes were "new equipment" as distinguished from "labor, supplies or material".

Statute Involved

This proceeding does not involve the interpretation of any statute, although the question arises in the administration of the Federal Bankruptcy Act relating to reorganization proceedings.

Statement

This is a proceeding by Johnson Fare Box Company to have a claim in a reorganization proceeding given priority under the so-called "six months' priority rule." *Most of the facts have been stipulated.* The claim is based upon the delivery of fare boxes by Johnson Fare Box Company (hereinafter sometimes referred to as "Johnson") to Surface Transportation Corporation of New York (hereinafter sometimes referred to as "Surface") made between February 7, 1949 and June 10, 1949, which was within six months of the appointment of the Trustees on June 21,

1949 (10a). The aggregate amount of fare boxes delivered during said period amounted to $55,959.84, of which there was paid $12,426, leaving a balance unpaid of $43,533.84. Under an amended proof of claim (2a-4a), Johnson demanded priority for this claim over all first mortgage bondholders, adjustment income mortgage bondholders, and all general creditors, except general creditors in the same class as Johnson. Priority was granted by the District Court to the extent of $42.84, leaving a balance in the amount of $43,491, which is the subject of this proceeding.

The jurisdiction of the District Court was invoked because the question related to a reorganization under the Federal Bankruptcy Act.

In the year 1949, the Debtors operated a public transportation system with buses and street cars in the Boroughs of Manhattan and the Bronx (New York City) and in the County of Westchester (New York State). Its operation required about 981 buses and 84 streets cars to carry passengers over 68 bus lines with a total route mileage of 331 miles, and 12 trolley routes with a route mileage of 36 miles (8a).

During the years 1948 and 1949, the total number of revenue passengers carried were 420,000,000 and 355,021,901, respectively (8a).

Until on or about September 22, 1948, the fare was five cents and all buses were equipped with a so-called "J" type of fare box, which was so constructed that a nickel inserted therein would register as one fare and a dime as two fares (11a).

On November 28, 1948, a seven cents fare was instituted. Thereafter, a tray was provided in each bus upon which the passenger was supposed to drop two pennies and insert a nickel in the fare box (11a). Due to unfamiliarity or thoughtlessness on the part of passengers, a certain percentage of them would insert the total fare in the fare

box, which then registered five fares, since a penny registered two fares, like a dime (11a). Considerable confusion developed with respect to the number of fares for which each bus operator should account (24a). As a result, Division Superintendents were authorized to refund to the bus operators the amounts erroneously registered, provided the bus operator made a claim and signed an appropriate refund slip (11a).

In order to offset the inevitable increase in the number of fares registered in the box by such insertion of pennies, many bus operators adopted the practice of taking certain fares "over the box" instead of having the fare inserted in the box (11a-12a). This practice opened the door wide to dishonesty and peculation on the part of the bus operators. In the course of several months, as a result of investigations by inspectors of Surface, a number of bus operators were suspended for this practice (12a).

The bus operators' union objected to the suspension and protested to the management that the basic cause of the trouble was its failure to provide proper fare collection devices (12a).

The Debtors recognized that the method of collecting the pennies in a tray imposed an additional burden on the bus operators and also slowed down the entrance of passengers into the buses (12a). As a result, they made a survey of the market to find the most practical fare box for collecting fares involving more than one coin. They found that the Johnson fare box (of the type here involved) was the most suitable and that it was used by the Board of Transportation of the City of New York and other privately owned bus lines in New York City. In fact, the Debtors, because of their urgent necessity, were then using 400 of them which they had borrowed from the City of New York (12a, 24a-25a).

Accordingly, on February 8, 1949, as a result of said survey, Surface placed an order with Johnson for 450 boxes

at a cost of $228 per box, plus 7% Federal Tax and 2% New York City sales tax, if the boxes were delivered for use in New York City. The Debtors requested credit for these purchases, but this was refused. Instead, Johnson insisted upon and Surface agreed to terms of thirty days net, and 1% discount if payment was made within ten days (10a). The Debtor's liability for payment for said boxes was a current liability, and the claim of Johnson represents a debt contracted with the expectation or intention of Johnson that it was to be paid out of the current earnings of the Debtor. The fare boxes so ordered and delivered were intended for and were actually used in the ordinary operations of Surface (13a). All of the fare boxes so ordered and delivered were intended for use and were actually used on old buses then in use, as replacements for the previously used "J" boxes. They were purchased for immediate use and not to provide an adequate margin of reserve for boxes out of order (13a).

Johnson had delivered 226 boxes up to June 21, 1949, the date of the appointment of the Trustees (25a).

It is undisputed that the fare boxes so delivered became part of the security included in the First Refunding Mortgage (16a).

On or about September 2, 1949, shortly after the appointment of the Trustees herein, the Trustees petitioned the District Court for leave to purchase 334 additional fare boxes for Surface and 115 additional fare boxes for the Debtor Westchester Street Transportation Company, Inc. The petition alleged that these additional boxes were being purchased "as a result of a study of the requirements of the debtors in this respect," and that the trustees and

> "the operating officers of the debtors are of the opinion that it is *necessary* to obtain an additional 334 boxes at a cost of $83,005.68 for use by Surface, and 115 boxes at a cost of $28,055.40 for use by Westchester Street." (25a-26a) (Emphasis supplied)

The petition referred to the earlier order of Surface for 450 boxes, placed with Johnson on February 8, 1949, and alleged that Johnson had delivered 226 of the boxes up to June 21, 1949, the date of the appointment of the Trustees. The petition then stated that the Trustees themselves had accepted delivery of an additional 25 boxes in the month of August 1948 (25a), that is, prior to the filing of their petition and, therefore, without prior approval of the Court.

The petition further alleged that the additional boxes to be purchased included the boxes previously ordered by Surface on February 8, 1949, but not as yet delivered (26a).

That petition was granted on September 8, 1949, and the order entered thereon authorized the Trustees to purchase a total of 449 additional fare boxes at a cost of $111,061.08, and *to pay for the 25 boxes which they had accepted without prior Court approval in August 1949 (22a).*

Johnson's Amended Proof of Claim (2a-4a) requested priority upon the grounds, among others, that the fare boxes were delivered to a transportation corporation within a period of six months prior to the appointment of the Trustees and were necessary for the continued operation of Surface; that the purchases were made in the ordinary course of business of Surface, were made to preserve the estate and were in the nature of "administration expenses"; and that the fare boxes became subject to the mortgage, thereby enriching the estate of the mortgagee and the Debtors without consideration.

At the District Court hearing on this claim, Mr. James T. Ellis, Comptroller for the Trustees and formerly Vice President and Treasurer of the Debtors, testified that, of the items included in the claim of Johnson, the sum of $42.84 representing fifteen housings for lights used in connection with fare boxes, had been charged to materials and supplies. The balance, however, representing fare

boxes, had been charged to "fixed capital property" which would be depreciated over a period of ten years (41a).

The District Court, after reviewing the difficulties which resulted from the use of the old fare boxes when the new seven cents fare went into effect, found that:

> "The substitution of boxes which would register the pennies therefore became *imperative* * * *." (Emphasis supplied) (47a)

Nevertheless, the Court held that, in proceedings of this type, priority should be accorded only to claims for "labor, supplies or material", but not to "new equipment." The Court further found that the fareboxes were "new equipment", and accordingly denied Johnson's request for priority (48a).

The United States Court of Appeals held that the conclusion of the District Court was a proper interpretation and application of the rule, and affirmed (Appendix A, at p. 27, *infra*).

Reasons Why the Writ Should Be Granted

A. Conflict between United States Supreme Court and the Second Circuit.

The essence of the decision of the Court below is that the six months' priority rule is limited to "labor, supplies or materials"; *that it does not include "new equipment"*; and that fare boxes fall into the latter category. This decision is directly contrary to the decisions of this Court.

In the leading case of *Fosdick* v. *Schall*, 99 U. S. 235, this Court expressly included "equipment" within the scope of the six months' priority rule, when it stated at page 252:

> "The income out of which the mortgagee is to be paid is the net income obtained by deducting from

> the gross earnings what is required for necessary operating and managing expenses, *proper equipment* and useful improvements. Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income." (Emphasis supplied.)

At pages 251-2, this Court further stated:

> "• • • the court, in the exercise of a sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms in reference to the payment from the income during the receivership of outstanding debts for labor, supplies, *equipment* or permanent improvement of the mortgaged property as may, under the circumstances of the particular case, appear to be reasonable." (Emphasis supplied.)

In *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257, the question before the Court was the right of a creditor to priority for steel rails supplied to a railroad shortly before the appointment of receivers. The record showed that the rails were purchased in order that the road might be kept in a reasonably safe condition. This Court granted priority to the claim and stated at page 278:

> "As was said in *Fosdick* v. *Schall* • • • 'the income [of a railroad company] out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, *proper equipment*, and useful improvements'." (Emphasis supplied.)

Further, at page 285, the Court set forth the principles applicable to this type of case, as follows:

> "This court has uniformly refrained from laying down any rule as absolutely controlling in every case involving the right of unsecured creditors of a corporation, whose property is in the hands of a receiver, to have their demands paid out of net earnings in preference to mortgage creditors. But it may be safely affirmed, upon the authority of former decisions, that a railroad mortgagee when accepting his security impliedly agrees that the current debts of a railroad company contracted in the ordinary course of its business shall be paid out of current receipts before he has any claim upon such income; that, within this rule, a debt not contracted upon the personal credit of the company, *but to keep the railroad itself in condition to be used with reasonable safety for the transportation of persons and property, and with the expectation of the parties that it was to be met out of the current receipts of the company, may be treated as a current debt;* that whether the debt was contracted upon the personal credit of the company, without any reference to its receipts, is to be determined in each case by the amount of the debt, the time and terms of payment, and all other circumstances attending the transaction; and that when current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of any funds thus improperly diverted from their primary use." (Emphasis supplied.)

The case at bar comes squarely within the principles so laid down by this Court.

The Stipulation of Facts expressly states that Johnson's claim was a "current liability" of the Debtor and

that "said claim represented a debt contracted with the expectation or intention of Johnson that it was to be paid out of current earnings" (13a). The current nature of the debt is conclusively demonstrated by the fact that long-term credit was requested by Surface and refused by Johnson (13a), and that the terms of payment agreed upon called for payment within thirty days, with a 1% discount if payment were made within ten days (10a). It was further expressly stipulated that the fare boxes were intended for and were used "in the ordinary operations of the Debtor and Surface"; that the boxes were intended for and were actually used on old buses as replacements for the previously used "J" boxes (13a); and that they were purchased for immediate use and not as a reserve (13a). These stipulated facts clearly demonstrate that the transaction was made in the ordinary course of the Debtor's business.

It is unnecessary to argue that "equipment" of certain types is beyond the six-months' rule. If, for example, that equipment consisted of an extension of a railway system, or the new construction of a car barn, or the laying down of additional tracks or new cars or locomotives, we would agree that the six-months' rule did not apply. But in the present case, the fare boxes were physically but an insignificant part of a bus, and their cost in relation to that of a bus, was inconsequential. Their importance, however, in safeguarding the financial integrity of the transportation line, and in insuring the safety and efficiency of operation, was of the highest magnitude. Whether they are characterized as "equipment," rather than "material or supplies" is of no consequence. As we have shown above, the Supreme Court of the United States on a number of occasions has recognized that in a *proper* situation, "equipment or permanent improvements" or "proper equipment and useful improvements" come within the scope of the six-months' rule. The Supreme Court did not mean to imply that equipment such as extensions of a railroad system or new rolling stock was to be encompassed within the

rule. The word or phrase is not in itself the sovereign talisman. It is the purpose, meaning and intent behind the word by which we must be governed.

The boxes were not ordered for nor were they used in any new buses or new operating equipment. There was absolutely no extension of the Debtor's transportation system.

The purchase of the the boxes was, in the words of the District Court itself, "*imperative*" (47a). This urgent need arose as a result of the increase in the fare from five cents to seven cents, an increase which was obviously of fundamental importance to the Debtor. As heretofore stated, the old boxes were inadequate, because they were incapable of accurately recording the pennies involved in the new fare. The plan of having passengers drop a nickel in the old box and place the pennies in a separate tray proved unworkable. Despite the presence of the tray, many passengers dropped the full fare of seven cents—a nickel and two pennies—into the fare box. In view of the fact that a penny registered the same as a dime, the dropping of the seven cents into the old box resulted in the registration of five fares (or thirty-five cents), for which the operator was required to account, instead of seven cents. The operator was, therefore, required to pay over this entire sum, and then make an application for a refund. This immediately raised the question of the honesty of his application for a refund, since the operator could state any number of persons that he chose as the number who had deposited the entire seven cents in the box. *There was no possible check upon the accuracy or truthfulness of his application.* The money deposited in the fare box, as is common knowledge, is not allowed to remain in the box, but is removed from the box by the operator for the purpose, among other things, of supplying him with necessary change. The registration on the box would have no bearing upon the actual number of

fares for which the operators were required to account. Apart from the absence of any control over the fares, a considerable amount of time would necessarily be lost by the operators having the necessary adjustments made at the conclusion of their run or thereafter. They would inevitably request payment for the time so lost.

Moreover, it was stipulated that the method of collecting pennies in a tray imposed an additional burden on the operators. It is common knowledge that, in New York City, bus operators, operating all alone as they do, an entire bus, are already heavily overburdened. This imposition of "an additional burden on the bus operators" would inevitably give rise to dissatisfaction on their part, to claims for higher compensation, to more inefficient or distracted service, and to consequent jeopardy of the safety of the traveling public. It was further stipulated that the situation "also slowed down the entrance of passengers into the buses" (12a). The net result was that efficiency of operation was impaired with consequent reduction of use by the public and reduction of income, wholly apart from the impairment to the public of proper transportation service. It is obvious that the *safety of the traveling public* was likewise jeopardized, with the distractions, irritations and delays inherent in the situation, particularly where, as in New York City, a bus operator is already much overburdened with duties, being the sole operator of a bus, in complex and crowded traffic.

The insoluble difficulties created by this system are evidenced by the fact that, rather than attempt to work thereunder, or solve them, many operators adopted the practice of accepting fares "*over the box*" (12a). This means that the entire fare would be paid to the operator, and there would be no registration whatever of the fact that a fare had been paid. This placed the company completely at the mercy of the operators and presented an intolerable problem. Obviously, Surface could not permit such a practice and operators were suspended

therefor. This resulted in difficulties with the Union, because, as the Union properly contended, Surface did not have proper fare boxes on the buses (12a). The situation was so intolerable that the conclusion must be drawn that the purchase of new fare boxes, which would properly register nickels, dimes and pennies, was, as the Court below held, "*imperative*" to the proper operation of the bus system.

The pressing need of Surface for the new boxes is further evidenced by the fact that, at the time the order was given to Johnson, Surface was using 400 of this type of box which had been borrowed from the City of New York (12a).

Moreover, the action of the Trustees shortly after their appointment is highly significant. First, in August 1949, without prior permission of the Court, they accepted delivery of 25 of the boxes formerly ordered by Surface (25a). Then, on September 7, 1949, a petition was presented to the District Court which not only requested permission to pay for these 25 boxes, but also requested authority to purchase 449 additional boxes at a cost of $111,060.98 (26a). The petition traced the difficulties arising out of the use of the old boxes and clearly spelled out the need of the Debtors for the new ones. Included in the new order to be placed by the Trustees were the very boxes previously ordered by Surface, but not yet delivered. This additional order was being placed "as a result of a study of the requirements of the debtors", and the petition expressly stated that both the Trustees and the operating officers of the Debtors believed that it was "*necessary*" to obtain the additional boxes (25a).

The significance of the action of trustees, shortly after their appointment, on the question of allowing priority to debts contracted by a transportation company prior to their appointment was recognized by this Court in *Southern Railway Co.* v. *Carnegie Steel Co., supra.* In

that case, immediately after the receivers had taken possession of the railroad, they reported to the Court that the financial difficulties of the road during the previous two years had

> "prevented the operating officers from being able to expend the proper amount for new rails, and upon the roadbed and structures, to keep the railroad in the condition in which it should be maintained, and it will be necessary for the receivers, during the summer and autumn, to make a much larger expenditure than they would for ordinary maintenance." (p. 288)

Commenting on this report, the Court stated at page 288:

> "Here is a direct admission by the receivers that during the two years immediately preceding their appointment the railroad company had not expended for new rails and upon the roadbed and structures the amount necessary to keep its road in proper condition."

The Court then noted that, during the course of the receivership, additional rails were purchased by the receivers. After holding that such purchases were made in the ordinary course of business and payable out of current receipts in preference to the claims of mortgage creditors, and incurred in the interest of the mortgage creditors, the value of whose security depended upon the preservation of the railroad, the Court then stated at pages 289-290:

> "Why should a different rule be applied to the contracts made with the Carnegie Company shortly before the appointment of receivers * * *? Is it to be said that the contract for 2,000 tons of steel rails and the contract for 2,500 tons, made by the receivers

in the foreclosure suit, created debts of a preferential character, while contracts made by the railroad company of exactly the same kind shortly before the appointment of receivers for 2,500 and 1,656 tons of steel rails could not under any circumstances become a preferential debt chargeable upon current receipts? Surely the quantity of rails purchased from the Carnegie Company and delivered in 1891 was insignificant in view of the interests involved and the extensive mileage of the Danville system, and was by no means so large as to suggest that they were to be used in constructing new and additional road, and not to keep existing roads in proper condition for use. Every railroad company must have on hand a limited quantity of rails in order to keep every part of its line in proper and safe condition. It is evident that the Carnegie rails purchased shortly before the receivers in the Clyde suit were appointed—the rails here in question—were obtained for the same reason that induced the subsequent purchases by the receivers. No one will say that the use of these rails did not add directly to the value of the securities of mortgage creditors. Within the reason of the rule adverted to, the debts contracted with the Carnegie Company were as much current debts in the ordinary course of the business of the railroad company as were the debts contracted by the receivers under the orders of court, when they purchased new rails to put the road in safe condition, or when they purchased at one time four passenger locomotives, and at another time eight passenger and freight locomotives, the cost of which was charged upon the income in their hands. Is it to be said that such expenses incurred by the receivers were preferential debts, but that debts incurred by the railroad company shortly prior to the receivership for rails needed to keep its road in safe condition for use are not of that class?"

Similarly, in the case at bar, the fact that the Trustees, after their appointment, accepted delivery of 25 boxes previously ordered by Surface, requested authority to pay therefor, and further requested authority to order additional machines as "*necessary*" is the strongest proof that the purchases made by Surface within six months prior to the appointment of the Trustees were equally necessary for the ordinary operation of the business.

There is no doubt that the new fare boxes purchased by Surface were covered by the First Refunding Mortgage (16a) and enured, therefore, immediately to the advantages of the mortgage security holders.

The fare boxes were physically but an insignificant part of the bus, and their cost in relation to that of the bus was inconsequential. Their importance, however, in safeguarding the financial integrity of the transportation line, and in insuring the safety and efficiency of operation, was of the highest magnitude. Whether they be characterized as "equipment" or "materials or supplies" is of no consequence. The fact is that they were truly necessary to continue the Debtor as a "going concern". To be sure, the Debtor could have operated its buses with the old fare boxes or even without fare boxes, but no transportation company could conduct such an operation without early disaster. The fact that the buses without any fare boxes at all had the requisite motive power does not mean that boxes were not "necessary" in every practical sense of the word for their operation. A bus line of the scope and magnitude of the Debtor had to have proper fare boxes, and boxes which had been designed for merely a five cent fare were useless after the seven cent fare went into effect.

Under the decisions of this Court, therefore, the claim of Johnson is clearly entitled to priority.

B. Conflict Between the Second and Fourth Circuits.

The narrow interpretation of the six months' priority rule by the Courts below is clearly contrary to the decisions not only of the Supreme Court of the United States, but also of the United States Court of Appeals for the Fourth Circuit. In that Circuit, priority has been granted to claims arising out of such necessary improvements as the conversion of a power plant from steam to water, the repair of a bridge, and even the erection of a new bridge. Moreover, the cases have expressly held that the mere fact that the cost of the improvement was charged to capital by the utility, as was done in the case at bar, does not disqualify the claim from priority.

In *Virginia Passenger & Power Co.* v. *Lane Bros. Co.*, 174 Fed. 513 (CA 4th), the claimant was under contract to widen and deepen a canal in connection with the conversion of a power plant from steam to water. The Court in granting priority to the claim stated at page 517:

> "It may have been proper for the company, as a matter of bookkeeping, to charge this improvement to construction account, but it is plain that the indebtedness incurred was for the permanent improvement of the mortgaged property. It was not a new construction in the sense that the building of a new railroad, or the building of a new plant, would be, but was, as said by the Judge below, '*something necessary in furtherance of the more effective and economical operation of the existing plant*'." (Emphasis supplied)

The above language is precisely applicable to the fare boxes involved here. They improved the mortgaged property, enured directly to the benefit of the mortgagees, they did not go into *new* buses but replaced the obsolete boxes in the existing vehicles, they did not involve in any way an extension of the transportation system, and they were

certainly "something necessary in furtherance of the more effective and economical operation of the existing plant."

The Court in the *Virginia Passenger & Power Co.* case then referred to the fact that the receivers, after their appointment, petitioned for authority to continue and complete the project and that this authority was granted, and stated at page 517:

> "That the receivers and the general manager of the company considered that the completion of the work upon the canal was absolutely essential to keeping the company a 'going concern' is evidenced by their acts, and that the court which had the responsibility of protecting the property and its bondholders was impressed by its necessity is shown by its orders, among the first entered after the appointment of the receivers. If that be so, how can it be justly claimed that the work done by the petitioners during the month immediately preceding the appointment of the receivers was not of equal necessity?"

The direct applicability of such language to the case at bar has already been discussed.

A petition to review the *Virginia Passenger & Power Co.* case by a writ of certiorari was denied in 215 U. S. 610.

In *Continental Trust Co.* v. *W. R. Bonsal & Co.*, 72 F. (2d) 975 (C. A. 4th), priority was requested in connection with claims for cross-ties, stone, steel pier casings and structural steel which had been furnished for the repair of one bridge, which required strengthening, and *the erection of a new bridge*, which was required because of the age and weakened condition of another old bridge. In granting priority, the Court stated at page 980:

> "The objection to the allowance of priority chiefly stressed by appellants is that the supplies furnished

were not for operation but for improvements or betterments to the property of the road, which was charged to capital account under the rules of the Interstate Commerce Commission. But we do not think that this is a valid objection to the allowance of priority. As said in the Carnegie Steel Co. case, supra, 'a debt not contracted upon the personal credit of the company, but to keep the railroad itself in condition to be used with reasonable safety for the transportation of persons and property, and with the expectation of the parties that it was to be met out of the current receipts of the company, may be treated as a current debt.' And the rule as stated in Fosdick v. Schall, supra, repeatedly quoted with approval, lists debts *for improvements* along with those for labor, supplies, and *equipment* as being entitled to priority, if incurred in order that the railroad may be continued in operation as a going concern." (Emphasis supplied.)

The Court further stated at pages 980-981:

"The principles applicable in determining priority for such claims are entirely different from those which control in matters of bookkeeping. Charges to capital account in the books of the railroads are made for the purpose of determining the amount of investment as a basis of rate making, bond issues, etc. Priority is allowed claims for supplies under the 'six months' rule, not because the supplies have not added to capital, but because they have been necessary to the continued operation of the road and have been supplied with the expectation that they would be paid for out of current income.

* * * * * * * *

"They are debts of the income, not because they would ordinarily be charged to current expense, but because they have been necessary to the production of the in-

come in the ordinary operation of the road. * * * What we do mean to say, however, is that, where the debt meets these requirements (as discussed in the opinion), it is not to be denied priority merely because the supplies furnished have resulted in improvements to the property *or have been charged to capital account.* * * * And in the face of these holdings (cases cited), it would be little short of absurd to say that one who has furnished supplies necessary to keep the road in operation, and who is otherwise entitled to priority under the six months' rule, is to be denied such priority upon the objection of bondholders merely because the supplies which he has furnished have improved the property and thus increased the security of these bondholders. * * * But in considering what items are to be included in such operating expenses, due regard must be had for surrounding circumstances; and a claim for supplies necessary to the continued operation of the road is not to be denied priority *merely because such supplies have been used in a structure which constitutes an improvement over one which it replaces.* It is quite customary in the history of large and growing railroads to replace worn-out equipment with equipment of a more costly character, designed to meet the demands of modern traffic; and mortgage bondholders are, of course, aware of these recurring necessities and practices. In every such case, the exercise of reasonable judgment is required to decide whether, in view of the magnitude of the business and of the replacement of old by new and better equipment, the operation crosses the line of usual and customary practice and becomes a work of extraordinary character for which no priority may be allowed." (Emphasis supplied)

Again, in the *Continental Trust Co.* case, the Court took note of the fact that the receivers had completed the work on the bridge which had been started by the railroad com-

pany prior to the receivership, and this was an important factor in reaching the conclusion that a priority right existed.

An application to review this decision by writ of certiorari was likewise denied in 293 U. S. 624.

C. The question presented is of far reaching importance to railroads and other public service companies and in the administration of the Bankruptcy Act.

We are dealing here with problems which relate not to private litigants, but to railroads and transportation companies which intimately and vitally affect the general public. It is common knowledge that such companies operate largely on credit, as this Court pointed out as far back as *Fosdick* v. *Schall, supra,* at page 252:

> "The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require; and when companies become pecuniarily embarrassed, it frequently happens that debts for labor, supplies, *equipment* and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, if not altogether avoided. In this way the daily and monthly earnings, which ordinarily should go to pay the daily and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debt. The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper *equipment* and *useful improvements.*" (Emphasis supplied)

It is apparent, therefore, that unless persons who would normally supply the materials and equipment necessary

for the continued operation of such companies are protected, they will withhold their vital credit and insist upon cash. Such a situation would obviously hasten the downfall of many companies whose finances are weak. The public interest requires that railroads and similar service companies be preserved and continued in operation in order to serve the general public. It is essential, therefore, that priority be accorded to creditors who, like Johnson, supply material and equipment necessary to keep them in operation within the recognized equitable period of six months prior to the appointment of a receiver or of trustees.

Conclusion

WHEREFORE, petitioner respectfully requests this Court to issue its writ of certiorari to the United States Court of Appeals for the Second Circuit.

JOSEPH LORENZ,
Counsel for Petitioner.

June 2, 1958.

Appendix A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 100—October Term, 1957.

(Argued December 5, 1957 Decided January 6, 1958.)

Docket No. 24731

JOHNSON FARE BOX COMPANY,

Claimant-Appellant,

—v.—

LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor,

Respondent-Appellee.

In the Matters of

THIRD AVENUE TRANSIT CORPORATION, *et al.*,

Debtors.

Before:

CLARK, *Chief Judge*,
MOORE, *Circuit Judge*, and SMITH, *District Judge*.

Appeal from the United States District Court for the Southern District of New York; Edward J. Dimock, *Judge*.

Appellant, Johnson Fare Box Company, appeals from an order denying the classification of its claim for $43,533.84

(except $42.84) against Surface Transportation Corporation of New York and Third Avenue Transit Corporation (referred to as "debtors") as a six months' priority claim.

Affirmed.

JOSEPH LORENZ, ESQ., New York, N. Y. (Lorenz, Finn & Giardino, John F. X. Finn, Jr., New York, N. Y., on the brief), *for claimant-appellant, Johnson Fare Box Company.*

JOHN A. KISER, ESQ., New York, N. Y. (Saxe, Bacon & O'Shea, Edward D. Burns, New York, N. Y., on the brief), *for Lester T. Doyle, Reorganization Trustee-Appellee.*

PER CURIAM:

Between February 7, 1949 and June 10, 1949 Johnson Fare Box Company (referred to as "Johnson") sold and delivered to the debtors 225 new fare boxes for use on their buses. The purchase prices of these fare boxes totaled $43,533.84. On June 21, 1949 trustees in bankruptcy were appointed for the debtors. Thereafter Johnson filed with the trustees claims for the purchase prices of these fare boxes, and sought a priority over bondholders and general creditors (except those in similar position to Johnson) under the so-called six months' priority rule, i.e., priority given to certain types of debts incurred within the six months preceding the appointment of trustees. These new fare boxes were required because of an increase in fare from five to seven cents. The old boxes would not register the new fare correctly if a nickel and two pennies were deposited because they were designed to record a nickel as one fare and a dime as two fares. Unfortunately, a penny

reacted in the box in the same manner as a dime so that the bus operator was confronted with the problem of trying to prevent the passengers from putting pennies in the box or, if unsuccessful, having more fares recorded and charged against him than passengers carried. Delay, confusion and dissatisfaction resulted.

The reason or motive, however, prompting the debtors to purchase the new boxes does not supply the answer to the legal question as to whether Johnson should be entitled to priority over secured and general creditors.

The so-called six months' priority rule is an invasion of the established contract rights of lienholders. As an invasion the rule should be strictly contained within narrow confines and limited to the purposes which brought it into being. In summary, the rule assumes that debts contracted during a short period, usually fixed at six months before a receivership, for labor, supplies or repairs necessary for a company's operation so redound to the benefit of the lienholders and other creditors that they should receive preferred treatment. On the other hand, new equipment purchased and new construction as distinguished from repairs would not fall within the preferred class. Thus, no matter how advantageous to the efficiency of the debtors' operations a purchase of new buses, for example, might have been, such indebtedness would not be entitled to a priority. As a practical matter, fare boxes were carried on the debtors' books as "Fixed assets operating property" and the debtors used "a ten-year write-off period for all fare box equipment."

As the court below said in a previous decision (*In Re Third Avenue Transit Corporation*, 138 F. Supp. 623; aff'd 2 Cir. 1956, 230 F. 2d 425) it is very difficult to discover "any principle which would account for all of the decisions" and that the only generality obtainable from an examina-

tion of the cases[1] is that "the decision in each one depended upon its special facts."

The conclusion reached by the court below that "the fare boxes were not 'labor, supplies or material' but rather 'new equipment' " was a proper interpretation and application of the rule and the order appealed from is affirmed.

Affirmed.

[1] *Fosdick* v. *Schall*, 99 U. S. 235; *Guaranty Trust Company* v. *Seaboard Airline Ry. Co.*, 14 F. Supp. 555, aff'd sub nom., *Union Switch & Signal Co.* v. *Powell*, 4 Cir., 84 F. 2d 25; *Crane Co.* v. *Fidelity Trust Co.*, 9 Cir., 238 Fed. 693. Compare *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257 (allowing priority for purchases of rails) with *Lackawana & Co.* v. *Farmers Loan & Trust Co.*, 176 U. S. 298 (decided the same day as the *Southern Railway* case but denying priority for purchases of rails). See generally FitzGibbon, The Present Status of the Six Months' Rule, 34 Col. L. Rev. 230.

Appendix B

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 6th day of January one thousand nine hundred and fifty-eight.

Present: HON. CHARLES E. CLARK, Chief Judge,
HON. LEONARD P. MOORE, Circuit Judge,
HON. J. JOSEPH SMITH, District Judge.

In the Matter of

THIRD AVENUE TRANSIT CORPORATION *et al.*,

Debtors-Appellees,

JOHNSON FARE BOX COMPANY,

Claimant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

A. DANIEL FUSARO,
Clerk.

Appendix C

SUPREME COURT OF THE UNITED STATES

No. , October Term, 1957

Johnson Fare Box Company, Petitioner, *vs.* Lester T. Doyle, Trustee in Reorganization of Third Avenue Transit Corporation, Debtor; Surface Transporation Corporation of New York, Debtor; Westchester Street Transportation Company, Inc., Debtor, *et al.*	Order extending time to file Petition for Writ of Certiorari.

Upon consideration of the application of counsel for petitioner,

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including June 5, 1958.

/S/ John M. Harlan,
Associate Justice of the
Supreme Court of the United States.

Dated this 2d day of April 1958.